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UNCLAS SECTION 01 OF 04 LAGOS 000634

SIPDIS

STATE PASS TO EXIM, OPIC AND TDA
EXIM for MSCURRY
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ENERGY FOR CGAY

SENSITIVE BUT UNCLASSIFIED

E.O. 12958: N/A
TAGS: EPET EINV PGOV NI
SUBJECT: OIL INDUSTRY CAUTIOUSLY EMBRACES NIGERIAN LOCAL CONTENT

¶1. (U) SUMMARY. The GON requires oil companies to use indigenous contractors in joint venture projects, with a current target goal for "local content" set at 40 percent of a company's aggregate spending on a project. Defining what constitutes local content and enforcing the target fairly and efficiently have proven difficult, and domestic fabrication and labor capacities remain low. The industry wants to ensure, as it undertakes the effort to increase indigenous participation in contracts, that the concept of local content is based on a contractor's ability for domestic value-added rather than on the nationality of the equity stakeholders alone. With restrictive legislation and higher local content targets on the horizon, the next several years offer an excellent opportunity for American companies both to participate in capacity building of Nigerian domestic firms, and to establish manufacturing and service operations in-country. END SUMMARY.

¶2. (U) The GON encourages foreign companies involved in the oil industry to maximize Nigerian participation in the projects they undertake. But local content targets are not codified and are administered in different ways by the Department of Petroleum Resources (DPR), the Ministry of Internal Affairs and the National Petroleum Investment and Management Services agency (NAPIMS). Interest and confusion over targets run high, as evidenced during the Offshore West Africa Conference held in Abuja March 17-19. According to Paul Heuper, Special Energy Advisor at the U.S. Department of Commerce, who was a presenter at the conference, the breakout session for local content discussion was attended by over 100 people (compared to 20 at other sessions), and at one point degenerated into a free-for-all shouting match between members of the audience and a Shell representative leading the discussion. Heuper told ECONOFF that there seemed to be no common understanding of what are the current and near-term GON goals, and no agreement as to what constitutes local content.

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WHAT IS LOCAL CONTENT: OWNERSHIP OR VALUE-ADDED?
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¶3. (SBU) Companies doing business in Nigeria's petroleum sector must obtain various business and project permits from DPR. The Ministry of Internal Affairs, meanwhile, limits the number of expatriates who can enter Nigeria to fill jobs. The limits on expatriate workers vary with the level of expertise required and the training or experience Nigerians may have to do the anticipated work. Furthermore, every contract worth $500,000 or more entered into by an oil company must be reviewed at multiple stages by NAPIMS, which insists that 40 percent of the aggregate spending on projects in Nigeria be on "local content." But, multinational oil companies and oil services firms alike complain that they have little guidance specifying what constitutes local content on any given project. In a recent meeting with Maureen Scurry of the U.S. Export-Import Bank (USEXIM), Tom Hoffman, Chevron Nigeria's General Manager for Finance and Information Technology, lamented that too often businesses that are essentially shell corporations owned by at least one Nigerian are used to partner with international firms for the purpose of technically meeting local content requirements, but the former contribute little by way of actual Nigerian input.

¶4. (SBU) NAPIMS, for example, may approve a refurbishing contract that includes as a subcontractor a firm owned by a Nigerian, even if that firm has minimal facilities in Nigeria and ultimately ships the parts to the United States or elsewhere to be retooled and then re-imported. Hoffman said his company would rather not use such firms because they provide no value

added to a project: they provide no inputs derived from Nigeria and may have few Nigerian employees other than those who own the company. According to Hoffman, such arrangements are neither cost effective nor sustainable. Phillip Chukwu, Group Managing Director of NAPIMS, admitted to ECONOFF on March 16 that in many people's minds, including Nigerians in both business and government, such arrangements are sufficient to meet local content requirements. Chukwu nonetheless agreed with Hoffman that the process would be more effective if the government established guidelines focused on a company's domestic value added to a project rather than the nationality of its owners.

CHEVRON'S LOCAL CONTENT VALUE MATRIX

¶5. (SBU) According to Chevron's Hoffman, his company uses a value matrix to determine the local content a contractor will provide if brought into a project. Elements that Chevron evaluates include the number of Nigerians the company employs and in what positions, the nature of the supply chain that will support the project, the extent to which raw materials to be used in the supply chain originate in Nigeria, and the amount of taxes the contractor pays to the Nigerian government. Gibson Ola, Chevron Nigeria's Supply Chain Manager, added that the company's goals regarding local content are to increase the value added in Nigeria and to build domestic capacity in the sector, including training Nigerians to work in oil services.

NAPIMS PROCESS SLOW AND BURDENSOME

¶6. (SBU) Chevron's Ola described Nigeria's local content regulatory regime as a work in progress. Hoffman said that in the absence of regulation, NAPIMS uses its contracting approval process to promote local content. According to Hoffman, projects worth $500,000 or more must be reviewed and approved by NAPIMS at several stages. NAPIMS officials evaluate everything from the advertisements a company will run for bid solicitation to the details of the contracts and subcontracts used at various phases of the project. NAPIMS chief Phillip Chukwu described his agency's relationship with the oil companies as advisory, but admitted that a project will not go forward without NAPIMS approval at each step.

¶7. (SBU) The NAPIMS approval process is often burdensome, according to officials in oil companies, oil services firms, and NAPIMS. The NAPIMS review is cumbersome and slow, to the point that the approval process sometimes is longer than the lifespan of the intended contract. By the time approvals are obtained in some instances, a new contract must be negotiated and maneuvered through NAPIMS all over again. Hoffman said the delays in the NAPIMS process add uncertainty and cost to Chevron Nigeria's contracts, which in turn hamper local content capacity building as project managers are less willing to work with unknown or new Nigerian firms in order to minimize the risk of further delays. Uncertainty in NAPIMS review frustrates oil services companies (OSC) as well. Ray Blanchard, Manager of Cooper Cameron's operations in Nigeria, told ECONOFF that his company never knows if its bids on contracts will satisfy NAPIMS local content rules, even though all but a handful of Cameron's employees are Nigerian including managers, and the company maintains relatively large office, workshop, and fabrication facilities in the Delta.

¶8. (SBU) NAPIMS' Chukwu agreed his agency's approval process sometimes takes longer than the timeframe of a proposed project, and said he is trying to streamline the review process. He said NAPIMS is considering reducing the number of departments involved in contract approval, and raising the contract threshold for the agency's review to perhaps one million dollars, which Hoffman also suggested would provide welcomed relief.

LEGISLATION FOR LOCAL CONTENT

¶9. (SBU) A bill submitted in 2003 to codify local content rules is scheduled for consideration in the National Assembly in late March. In the meantime, NAPIMS plans to increase local content goals from 40% of aggregate spending on a project to 45% by 2006 and 70% by 2010. Chevron managers told us that the oil industry in Nigeria is working as a group through the Oil Producers' Trade Section (OPTS) of the Lagos

Chamber of Commerce to shape the bill, but more important, the accepted definition of local content. Chevron's Hoffman said that in addition to pressing the view that Nigerian value added is more important than equity stake, the industry will press to see that local content requirements work to the advantage of firms having such capability in bid qualifications. According to Hoffman, the industry would like to see companies contributing a greater percentage of value added local content win contracts even if other technical elements, such as longevity or financial liquidity, are less developed than competitors offering little value added.

INDUSTRY SEES WRITING ON THE WALL

¶10. (SBU) When asked why the industry is pursuing what appears to be the more restrictive local content requirement based on value added, Hoffman admitted that the oil companies see the writing on the wall and know they need to help shape the legislation if it is to be "done right." Hoffman said there is a risk to using shell companies to meet local content goals because sometimes such companies have little capacity to deliver on contracts, forcing project managers to hire additional contractors to do the same work. These delays, along with the delays in NAPIMS approvals, are more costly to the foreign oil companies than are higher contract costs associated with doing business with firms offering more value added, even if the latter need assistance in capacity building. Greater local content improves the net project value if it reduces project delays, according to Hoffman.

¶11. (SBU) Hoffman also said that value added local content should be more cost effective over time. He and Chevron's supply manager Ola said principles of corporate responsibility also demand a commitment to tangible local content. They also noted that future corporate opportunities, like gas exploration, lie in developing economies like Nigeria, and developing local content will help access those opportunities.

CAPACITY BUILDING

¶12. (SBU) Hoffman identified four requirements for development of Nigeria's local content in the oil sector. First, capacity and capability must be built. There are too few indigenous firms in Nigeria that can provide the products, fabrication or services needed by the international oil companies operating in the country. Hoffman said business management must also be improved so that companies like Chevron Nigeria can be confident that subcontractors will perform as contracted and will be sustainable and grow over time. He said financing is a major issue, particularly with start-ups. And finally, Hoffman stressed that companies like his must be willing to make mid- to long-term business commitments to indigenous firms.

¶13. (SBU) Hoffman admitted that his company's worldwide procurement practices appear contradictory to the goals outlined above, in that ChevronTexaco, as a multinational corporation, pursues a policy of "strategic sourcing." ChevronTexaco tries as much as possible to do business with suppliers and service companies that can provide products and services worldwide, rather than to have its regional business units enter into multiple contracts for the same item. Chevron Nigeria's Hoffman said that 90 percent of his company's overall spending in terms of dollar value and employee time goes toward 10 percent of its contracts. In other words, Hoffman said, Chevron tends to do business with "the big boys" and large contracts. Nonetheless, ChevronTexaco aims to leverage its worldwide strategic sourcing by encouraging its major suppliers to look to Nigeria as a place to establish manufacturing, fabrication or servicing bases. In 2003 Chevron Nigeria brought 14 of its biggest suppliers to Nigeria for site visits and discussions centered on possible establishment of operations here, a result of which would give Chevron reason to continue or expand its contracts with these suppliers, all the while meeting local content rules of one of its key markets.

LEVERAGING LOCAL CONTENT FOR U.S. BUSINESSES

¶14. (SBU) CONGEN and USEXIM staff discussed with Chevron's supply chain team the opportunities for American businesses in Nigeria in the context of the

local content requirements. ECONOFF also discussed the same with NAPIMS Group Managing Director Phillip Chukwu and a group of managers from DPR. It may appear that local content rules could thwart U.S. business opportunities by limiting access to Nigerian projects. But it was acknowledged by both corporate and government officials that Nigeria lacks capacity to provide significant local content in part because in the near to mid-term the GON and domestic firms will lack the financial wherewithal to make significant investments in domestic capacity.

¶15. (SBU) COMMENT: Chukwu admits extensive foreign investment is needed to sustain and grow the petroleum sector, especially Nigeria's fledgling gas industry. Accordingly, potential exists for American firms to take advantage of the development of local content standards in Nigeria in several arenas, by providing input for local fabrication, facilities and skills training for domestic refurbishing businesses, and technical partnerships for service contracts. Broader ventures might include establishing a Nigerian presence along the lines of Chevron's strategic sourcing concept.

¶16. (SBU) COMMENT CONTINUED. Maureen Scurry of USEXIM noted that USEXIM can help finance American training programs in Nigeria. This seems to be a little known or contemplated concept here. Both corporate and government representatives agreed training needs are great and will be ongoing in Nigeria; American companies may want to take advantage of the opportunity to provide such training with USG assistance. American supply and service firms that can manage the ongoing challenges of infrastructure, political risk, and security in Nigeria may have a unique opportunity in the coming years to capitalize on the inevitable march resulting in greater local content, all the while improving Nigeria's domestic capacity, which will ultimately improve the country's overall economic footing and provide opportunities for investment in other sectors. END COMMENT.

HINSON-JONES